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HIGHLIGHTS

Greenberg's Limited Win a Blow To Wall Street's Dodd-Frank Fight

Hank Greenberg's legal victory could turn out to be a loser for Wall Street in its fight to soften financial rules. By successfully arguing that the Federal Reserve broke the law when it propped up American International Group Inc., Greenberg added another bailout deterrent to a series of provisions implemented since the 2008 crisis that make it harder for the government to rescue financial firms. **Page 1163**

EU Reaches Deal on Bank Bill As France Wins Late Concessions

EU finance ministers strike a deal on a law to tackle too-big-to-fail banks after France secured a last-minute technical change to exemptions planned for U.K. lenders. France had scuppered talks by envoys from the EU's 28 nations earlier the week of June 15 by seeking several changes to the bill, which addresses how supervisors should determine whether banks should have to split off trading activities from consumer services. **Page 1163**

Fund Managers Win Reprieve As Too-Big-to-Fail Plan Shelved

The world's biggest investment managers win a reprieve from plans to label them as systemically important, staving off tougher regulation, as global authorities reassess the move. The International Organization of Securities Commissions, one of two global standard-setters working on the measure, said priority would now be given to a ''broader'' study of ''asset management activities,'' in a statement June 17. **Page 1165**

The Insider 'Born at the Federal Reserve' Is on the Hot Seat Now

He played a key role in the controversial bailout of American International Group Inc. He is central to how Dodd-Frank is put into practice. Most everything of significance at the Federal Reserve Board goes across his desk. And you have probably never heard of him. **Page 1164**

BNA INSIGHTS: Relying on Others to Carry Out AML Functions

The author argues the notion of relying on others to carry out anti-money laundering (AML) functions has become increasingly attractive, if not inexorable, over time. He writes that a judgment about when reliance is wise requires thinking about what kinds of things are the likely subjects of reliance, when reliance actually occurs, what kinds of entities or persons are those upon which reliance is common and what the basic framework is for making reliance reasonable. **Page 1189**

LEGAL NEWS

SYSTEMIC RISK: MetLife Inc. asks a federal court to unwind the Financial Stability Oversight Council's designation of the insurer as ''systemically important'' and halt further proceedings. **Page 1179**

ANTITRUST: American Express Co. must comply with an order requiring it to drop rules that prohibit merchants from asking customers to use less-expensive credit cards, as a federal appeals court rejects the company's request for a delay pending an appeal. **Page 1180**

FAIR LENDING: Lenders should expect to see wider use of an imperfect but influential analytical tool used to gauge fair lending performance outside the mortgage lending space, lawyers tell an American Bankers Association (ABA) meeting June 16. **Page 1180**

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BNA Insights

MONEY LAUNDERING

The author argues the notion of relying on others to carry out anti-money laundering (AML) functions has become increasingly attractive, if not inexorable, over time. He writes that a judgment about when reliance is wise requires thinking about what kinds of things are the likely subjects of reliance, when reliance actually occurs, what kinds of entities or persons are those upon which reliance is common and what the basic framework is for making reliance reasonable.

BNA INSIGHTS: Murky Shoals – Relying on Others to Carry Out AML Functions

BY ROBERT M. AXELROD

"It didn't happen. If it happened, I didn't do it. If I did it, the Devil made me do it.'' We need to add to this litany, the following: ''The Devil *promised me, sincerely,* he would do it for me, but he didn't.''

The notion of relying on others to carry out anti-money laundering (AML) functions has become increasingly attractive, if not inexorable, over time. The nature of AML requirements is ever more technology oriented. The efficiency of others acting as a utility has grown with the recognition of the benefits in efficiency and effectiveness. The complexity of the various AML tasks is such that one single business or operations unit within a large financial institution may not always have an intuitive grasp of everything there is to do or have enough personnel with the requisite skillset.

Robert M. Axelrod is a director in Deloitte Transactions and Business Analytics LLP, an affiliate of Deloitte Financial Advisory Services LLP. He specializes in projects addressing financial transactions in regulatory and compliance contexts, including anti-money laundering and antiterrorist financing, as well as anticorruption concerns in the financial services industry, specifically addressing banks, insurance companies, and broker dealers.

As a result, financial institutions may consider relying on outsiders, of one sort or another. This is particularly true for relatively newer entrants to the AML regulatory world, such as money services businesses, whose operations had not traditionally taken AML functions into account as comprehensively as is now expected. Making a judgment about when reliance is wise requires thinking about what kinds of things are the likely subjects of reliance, when reliance actually occurs, what kinds of entities or persons are those upon which reliance is common and what the basic framework is for making reliance reasonable.

What Kinds of Things Are the Likely Subjects of Reliance? Almost any AML function can be attractive for handling by third-parties. Customer due diligence and enhanced due diligence, transaction monitoring, screening for sanctions hits, filing currency transaction reports, training, independent testing and creating analyses of suspicious activity and risk are just a few items. Thus, a bank or a broker might contract with an-

other party, including other financial institutions, to collect all the information about its customers that is required under the governing regulations. This is a particularly salient kind of reliance, with various potential know-your-customer (KYC) utilities arising on the theory that customers might appreciate having a one-stop-shopping experience with a utility, rather than conveying the same information separately to the numerous financial institutions with which they hold accounts.

When Does Reliance Actually Occur? There is a difference between mere help and reliance.[1] If a bank is designing a risk assessment and seeks guidance and recommendations from a consultant, the bank is not relying on the consultant to carry out its obligation to perform a risk assessment. A broker that has an outside service provide internet research for each customer to the broker's databases is still carrying out its own customer due diligence, even though it is taking information from another. On the other hand, a broker that relies on another broker to gather CIP but that does not even ingest the CIP data into its own processes or verify it in any way, is relying on another party to perform an AML function.

Given the regulatory limitations on reliance and consequences of reliance, it may often be advantageous for an institution to exercise care in when it actually chooses to rely upon another, and how it wishes to characterize its activities as reliance.

Given the regulatory limitations on reliance and consequences of reliance, it may often be advantageous for an institution to exercise care in when it actually chooses to rely upon another, and how it wishes to characterize its activities as reliance. In this connection, the 2014 *Federal Financial Institutions Examination Council Bank Secrecy Act/Anti-Money Laundering Examination Manual* comparison between the safe harbor reliance for CIP on a U.S. regulated institution, and reliance outside that safe harbor, is instructive in two ways. First, it acknowledges without criticism that non safe harbor reliance may occur, and the prudent way to go about it. Second, it underscores that responsibility does not shift without a safe harbor:

> ''However, as with any other responsibility performed by a third party, the bank is ultimately responsible for that third party's compliance with the requirements of the bank's CIP. As a result, banks should establish adequate controls and review procedures for such relationships. This requirement contrasts with the reliance provision of the rule that permits the relied-upon party to take responsibility.''[2]

As a related matter, reliance can be distinguished from sharing. Clearing and introducing broker dealers both have responsibilities to carry out surveillance of transactions as part of their independent obligation to recognize and report suspicious activity. Some of the responsibility for surveillance of the transactions is allocated to the clearing firm, and some to the introducing firm. To some extent, the introducing firm will be deemed to be reasonable in relying upon the clearing firm to perform the clearing firm's share, although, as with any reliance, the introducing firm should have a reasonable basis to believe this was taking place.

What Kinds of Entities or Persons Are Relied Upon? This is a tricky issue. We often think of reliance regarding true third parties. Another completely separate financial institution or a vendor may be relied upon for an AML function. The nature of the parties relied upon, however, may be broader. An insurance company might rely on its agents or its affiliates. A bank line of business may rely on an operations group or another line of business with common customers or issues. In some instances, a business may rely upon a knowledgeable individual who sits in a completely different area from the business to carry out a function.

From a risk perspective, reliance within a single legal entity or even a set of affiliated entities may seem like a non-occurrence, because responsibility is still borne by the same entity, anyway. So why get involved with the fact or characteristics of reliance within a single entity? From a personal accountability or business line accountability point of view, however, the issues of reliance very much survive intact. Does the New York branch of a bank rely on the European home office for independent testing? Does a money services business rely upon employees of its holding company to provide necessary AML training? Does the private banking division rely on the retail division (where private banking customers frequently have linked accounts) for sanctions screening? And does the head of a business line rely upon another business line to have the customer due diligence carried out for customers? In all these settings, the prudence of reliance within an organization may become very important, both in terms of the quality of performance and the allocation of responsibility.

What Makes Reliance Reasonable? This is a two part issue. The underlying issue is what happens when the reliance is misplaced – how are the consequences allocated? The remaining issue is what needs to be done to make the reliance reasonable such that the impact on the disappointed (relying) party is largely or entirely mitigated?

With few exceptions, such as the Customer Identification Program,[3] even reasonable reliance is not a panacea. The company responsible for an AML function relies at its peril. It may have a good argument that it acted reasonably and in good faith, but that is not the same as having formally discharged a regulatory obligation solely by relying upon another. For persons within a legal entity, the question of reliance may arise

[1] This article is not providing legal advice or opinion concerning ''reliance'' or any other matter, which can of course be sought through legal counsel.

[2] Fed. Fin. Insts. Examination Council, 2014 Bank Secrecy Act/Anti-Money Laundering Examination Manual (2014), at 52.

[3] See 31 C.F.R. § 1020.220.

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insofar as there is regulatory accountability for lapses, or in the context of promotion and compensation discussions. *Those who rely need to understand that when the performing party fails, the relying party will frequently be left with responsibility for the failure, albeit with a mitigating explanation.*

To make reliance reasonable, there are both pertinent regulatory guidance and regulatory examples, particularly for relying on third parties. The regulation for CIP reliance[4] requires reasonableness, but does not define it. Presumably, the relying party needs to establish a number of factors, such as:

- Is the performing party able to do the function?
- Does it have available personnel suitable to the task?
- Is the performing party actually performing?
- Is there an ongoing testing process to show performance isn't gradually degrading?
- Can the relying party seasonably access the fruits of the performance, such as the customer information gathered?

The regulation also requires that the performing party provide a certification of its performance. Additionally, the arrangement must be formalized in a contract.

Recent Office of the Comptroller of the Currency guidance regarding the use of third parties in general provides additional insights applicable to reliance.[5] What are the alternatives for the use of a particular third party? Are the people who are relying sufficiently sophisticated to intelligently choose the performing party, and to evaluate, on an ongoing basis, whether performance is good? Has appropriate thought been given to how critical the item is for which reliance is being considered, and the degree of reliance that is actually chosen? How responsive is the level of due diligence on the performing party regarding the risks involved? It is prudent to identify the possibility that there will need to be termination of the services of the performing party, or that the performing party may at some point lose its initial capacity to perform. Along these lines, the relying party should have a solid understanding of the performing party's own risk management and compliance structures, its insurance and business continuity provisions, as well as its data security and integrity. In addition, the relying party should evaluate contingencies for various disruptions.

Reliance Within an Organization. The factors set out above appear natural and reasonable for working with an outside party. Even without guidance and regulation, businesses could be expected to exercise appropriate care when choosing a party to rely upon, including well-crafted contractual obligations that spell out what the performing party must do and the consequences if they do not. Internal reliance, however, has given rise to a much more variable set of practices. Some institutions have granular service level agreements that formalize cross-business reliance.[6] Others find these too cumbersome and perhaps too difficult to update when functional reliance changes in a fluid fashion, as it often does. While a third party is often the subject of a regular audit, the internal testing of reliance functions may be more episodic and less rigorous.

The performing business line may hesitate to undertake a task if it must enter into a relatively formal contract with the relying party, and that may in turn cause the relying party to be less demanding as to the prerequisites to rely. Experience has shown, however, that the care and diligence that takes place in selection and testing is critical in obtaining the kind of performance that reliance anticipates in the first place. Transparency of reliance may increase the burden of testing and auditing upon both the performing and relying business divisions, but it can also facilitate better overall performance of the key AML functions that are at the heart of the matter. That applies equally to internal reliance, as long as people are involved. Further, as regulators and prosecutors continue to ramp up their emphasis on personal accountability, the relying parties in these internal reliance situations have a growing stake in greater formality and documentation of the reasonableness of their reliance.

Concluding Perspectives. Finally, one should keep in mind some of the basic limitations of any reliance. A third party (or another internal party) cannot supplant AML program operation – you may rely on someone else to gather CIP information, but when you risk rate your clients, you need to be able to use that information with the same facility as if you gathered and stored it yourself. An operations unit or compliance unit within a bank may be carrying out transaction monitoring. However, if you head a business line, you need to know and respond to the nature of the risks and typologies that have been uncovered regarding the business line you supervise or otherwise have responsibility for. Reliance may be increasingly inevitable on one level or another, but many safeguards and limitations are now well established, and should be considered and periodically reconsidered. Perhaps the opening salvo here is, what kind of reliance is actually going on at your institution? Once that inventory is established, the evaluation and enhancing of the safeguards and the reflection on the wisdom of the reliance choice should be pretty straightforward.

[4] Id.

[5] As to third party consultants, see Third Party Relationships, OCC Bulletin No. 2013-29 (Oct. 30, 2013), http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html. As to guidance specific to the use of independent consultants, especially in an AML context, see Use and Review of Independent Consultants in Enforcement Actions, OCC Bulletin No. 2013-33 (Nov. 12, 2013), http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-33.html.

[6] Alternatively, the arrangements can be documented in policies and procedures, but these do not, by themselves, create the agreement framework that has been prescribed for third party situations, and they do not anticipate the cross business line oversight one might expect for reliance.